



UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON GOVERNMENT REFORM — MINORITY STAFF
SPECIAL INVESTIGATIONS DIVISION
JULY 2003

TAX ANALYSIS FOR REP. MARTIN OLAV SABO

THOUSANDS OF WORKING FAMILIES IN MINNESOTA'S 5TH CONGRESSIONAL DISTRICT WILL NOT BENEFIT FROM THE INCREASE IN THE CHILD TAX CREDIT

On May 22, 2003, the House and Senate passed a tax cut that could cost more than \$1 trillion over the next decade. The benefits of this tax cut will go disproportionately to wealthy taxpayers, who will derive significant benefits from the reduction in taxes on capital gains and dividend income.¹ In contrast, low- and middle-income taxpayers will receive small benefits, with many receiving no tax breaks at all.²

For most low- and middle-income families, the largest reduction in their taxes will be due to the expansion of the child tax credit from \$600 to \$1,000 per child. However, last-minute decisions by Republican tax negotiators denied this expanded credit to millions of low- and middle-income families.³

At the request of Rep. Martin Olav Sabo, who represents the 5th Congressional District of Minnesota, this analysis examines the impact of the decision to deny the expanded child tax credit to these working families. It finds that over 15,000 working families in Rep. Sabo's congressional district are denied benefits from the expansion of the child tax credit under the legislation.

Background

A child tax credit of \$500 per child was initially included in tax legislation passed by Congress and signed by President Clinton in 1996. The 2001 tax legislation signed by President Bush increased the credit to \$600 per child in 2001 through 2004. This 2001 legislation also ensured that to a limited extent, the credit was refundable, meaning that low-income families with no income tax liability could receive a tax refund. This refundability was due to the recognition that even if these families pay no income taxes, they still pay Social Security, Medicare, and other taxes.

The 2001 tax legislation made the child tax credit refundable in an amount equal to 10% of earnings above \$10,500. Thus, a married family with one child would need an income of at least \$16,500 to receive the full \$600 refund. A married family with two children would need an income of at least \$22,500 to receive the full refund of \$1,200.

The tax legislation passed by the Senate in May, which increased the child tax credit to \$1,000, also expanded the refundability of the credit. This Senate legislation made the credit refundable in an amount equal to 15% of earnings above \$10,500. Thus, a married family with one child and an income of \$16,500 would still qualify for almost the full \$1,000 credit.

However, the House and Senate Conference dropped the provision to increase the refundable amount of the credit from the final tax legislation. The result is that an estimated nine million families with children will receive no benefit from the increase in the child tax credit. Under the final bill, families with one child who have incomes below \$16,500 could be denied any benefit from the increase in the child tax credit. For families with more children, the threshold rises proportionately. For example, a family with three children with an income below \$28,500 could be denied any benefit from the increase in the child tax credit.

The rationale for preventing these families from receiving the expanded child tax credit was that the total cost of the tax legislation could not exceed \$350 billion over ten years. A spokeswoman for the House Ways and Means Committee indicated that “adjustments had to be made” in order to retain the large tax cuts in dividends and capital gains while keeping the bill under the \$350 billion figure.⁴ However, other analysts have noted that the cost of the tax credit was less than 3% of the total cost of the dividend and capital gains provision, so it could easily have been retained with only minor adjustments to these provisions.⁵ Tax experts have also indicated that the \$350 billion limit on the cost of the bill relies primarily on gimmicks, such as legislatively “phasing out” tax cuts in future years when these cuts are in fact expected to become permanent. Without these gimmicks, the tax cut could cost over \$1 trillion.⁶

On June 5, 2003, the Senate passed corrective legislation designed to restore the expanded refundability of the child tax credit originally passed by the Senate.⁷ After passage of this legislation, Republican leaders in the House claimed that they would “stand and fight” against the Senate legislation,⁸ and that “there are a lot of other things that are more important” than expanding the tax credit.⁹ One week later, the House did pass legislation that included an expansion of the tax credit.¹⁰ However, this legislation included unrelated provisions that raised the cost of the legislation to over \$80 billion. House leaders also removed a provision in the Senate legislation ensuring that the tax credits would be mailed to families this summer. Because the Senate is unlikely to agree to legislation that contains these provisions, it remains unclear if, and when, low-income families will receive the child tax credit.¹¹

Methodology

Rep. Sabo, who represents Minnesota's 5th Congressional District, requested this analysis in order to determine the number of taxpayers in his congressional district who will not receive any benefits from the child tax credit expansion. The analysis relies on state-level data to determine the percentage of taxpayers in Minnesota with incomes between \$10,000 and \$25,000 who will not receive any benefit from the child tax credit expansion. The analysis then applies this percentage to IRS data on the number of families in Rep. Sabo's district with incomes between \$10,000 and \$25,000.¹²

The Impact of the Failure to Expand the Child Tax Credit to Low and Middle-Income Families in the 5th Congressional District

There are an estimated 535,000 taxpayers with incomes between \$10,000 and \$25,000 in Minnesota.¹³ Analysts have estimated that 108,000 of these taxpayers — 20% of all taxpayers in this income group — will receive no benefit from the expansion of the child tax credit.¹⁴ Statewide, an estimated 198,000 children live in these families.

In the 5th Congressional District, there are an estimated 77,000 taxpayers with incomes between 10,000 and 25,000. Assuming 20% of these taxpayers receive no benefits from the expansion of the child tax credit, an estimated 15,500 low- and middle-income working families in Rep. Sabo's congressional district would receive no benefits. An estimated 28,500 children live in these families.

Proposals to Expand the Child Tax Credit to Low- and Middle-Income Families

There are presently a number of proposals in Congress to resolve the problem of low- and middle-income families who do not benefit from the increase in the child tax credit. Legislation supported by Rep. Sabo — the Working Taxpayer Fairness Restoration Act of 2003 (H.R. 2325) — is similar to the corrective legislation that has already passed the Senate, and would increase the refundability of the child tax credit for working families. This proposal would provide additional benefits for an estimated 6.5 million families in the United States. These families have 11.9 million children.¹⁵

In Minnesota, the Working Taxpayer Fairness Restoration Act would provide tax benefits to 84,000 families with 163,000 million children.¹⁶ These families represent 16% of taxpayers in the state with incomes between \$10,000 and \$25,000.

In the 5th Congressional District, this legislation to expand the child tax credit and reduce the marriage penalty would provide additional benefits for an estimated 12,100 families with 23,400 children.

Endnotes

¹ Center for Tax Justice, *Final Tax Plan Tilts Even More toward Richest* (May 22, 2003).

² Center for Tax Justice, *Most Taxpayers Get Little Help from Latest Bush Tax Plan* (May 30, 2003).

³ *Tax Law Omits Child Credit in Low-Income Brackets*, California Times (May 29, 2003).

⁴ *Children Left Behind*, Washington Post (June 2, 2003).

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- 5 Center for Budget and Policy Priorities, *Was There Enough Room in the Tax Bill for the Low-Income Child Tax Credit Provision* (May 30, 2003).
- 6 Center for Budget and Policy Priorities, *New Tax Cut Law Uses Gimmicks to Mask Costs* (June 1, 2003).
- 7 S. 1162.
- 8 *Senate Votes to Expand Child Tax Credit to Low-Income Families*, Washington Post (June 6, 2003).
- 9 *DeLay Rebuffs Move to Restore Lost Tax Credit*, New York Times (June 4, 2003).
- 10 H.R. 1308.
- 11 *House Expands Child Tax Credit as Part of Larger Cut*, New York Times (June 13, 2003).
- 12 This estimate is determined using IRS zip code-level data that shows the number of taxpayers in each zip code within a given income range. The district-level analysis includes all zip codes within the district. In cases where a zip code was split between two congressional districts, the analysis assumes that half the taxpayers within a given income level in the zip code live in each district. In cases where a zip code was split between three congressional districts, the analysis assumes that one third of the taxpayers within a given income level in the zip code live in each district.
- 13 Internal Revenue Service, *Individual Income Tax Returns: Selected Income and Tax Items by State, ZIP Code, and Size of Adjusted Gross Income, Tax Year 1998* (2003).
- 14 Center for Tax Justice, *Bush Tax Plan's Child Credit Boost Leaves behind One in Four of America's Children* (May 29, 2003).
- 15 Citizens for Tax Justice, *One in Six Families with Children Would Gain from Increasing Child Credit Refund Percentage* (June 3, 2003).
- 16 *Id.*